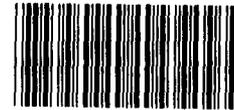


GAO

Testimony

Before the Committee on Post Office and Civil Service
House of Representatives



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Postal Automation and Pricing
in the 1990s

Statement of L. Nye Stevens, Director
Government Business Operations Issues
General Government Division



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POSTAL AUTOMATION AND PRICING

SUMMARY OF THE STATEMENT OF L. NYE STEVENS DIRECTOR, GOVERNMENT BUSINESS OPERATIONS ISSUES

During the past 20 years, the Postal Service's competitive position in the marketplace has eroded, especially in parcel post and overnight mail. Now rising postage rates in the First- and third-class markets have encouraged competition and diversion to other forms of communication. The Postal Service recognizes that to be competitive it must control the growth in operating costs; offer its customers a full range of services that are prompt, reliable, and courteously delivered; and price its services to reflect changing demands for its products.

GAO believes that Congress should reexamine the nine criteria that the Postal Rate Commission considers in the ratemaking process to determine if the criteria are still valid in light of changing marketplace realities. In particular, demand pricing and volume discounts may be appropriate pricing strategies to stem losses in the price sensitive third-class market, which could drive up the cost of First-Class postage to cover these losses. Congress could then be faced with demands to further open postal markets to competition, or to subsidize the national delivery network through appropriations.

Increased ratemaking flexibility will not, in itself, guarantee survival of the Postal Service in the competitive marketplace. Control of operational costs is also essential and the Postal Service is depending heavily on the automation program to improve productivity. However, although the Postal Service's automation program is producing savings in certain functional areas, it is unlikely to be a panacea that will reverse the persistent tendency for costs to outpace inflation. Notwithstanding a decrease in career employment, total hours of work increased in 1991 although the volume of mail declined.

Workhour savings that have been achieved by automation are also being overwhelmed by annual increases in labor hour costs. GAO estimates that workhour savings in 1991 related to automation amounted to about \$138 million. But the work in those functions cost \$627 million more than the year before because of wage and benefit increases.

Mr. Chairman, Mr. Gilman, and Members of the Committee:

We are pleased to be here today to participate in the Committee's oversight hearings on the United States Postal Service. Over 20 years have passed since the Postal Service was reorganized as a governmental quasi-corporation, sharing characteristics both of a business and a public service. During these 2 decades, it has accomplished many of the goals Congress set forth in the Postal Reorganization Act of 1970. It has modernized its operations, improved the compensation and working conditions of postal employees, foregone the direct taxpayer subsidies that used to support its operations, and maintained its mandated universal service. Today, however, the Postal Service is operating in a fundamentally different and increasingly competitive communications marketplace from the one that existed in 1970. Competition and the need to raise prices to cover continued escalation in its operating costs threaten the viability of this important institution.

Because of the changing postal environment, there are two significant issues that we would like to focus on today. They concern (1) changes to the ratemaking process to permit the Postal Service to meet the competitive demands of the marketplace and (2) efforts by the Postal Service to meet its competitive challenges by improving productivity and controlling costs through automation.

POSTAL RATEMAKING

As you will hear from other witnesses today, the Postal Service's Board of Governors and Postal Rate Commission established a joint task force last year to identify ways to improve the postal ratemaking process. In commenting on this action, former Postmaster General Anthony M. Frank said, "The Postal Service can't maintain its competitiveness, its responsiveness to its customers, its drive for greater efficiency or the highest levels of quality service to the American people if it does not receive more flexibility in the ratemaking process." We agree with this statement. In our March 1992 report to Congress,¹ we discuss the competitive threat facing the Postal Service, the constraints and obstacles that affect the Postal Service efforts to compete effectively, and the major issues of postal ratemaking in a competitive environment. I will briefly summarize some of the major points in the report.

During the past 20 years, the Postal Service's competitive position in the marketplace has eroded, especially in the parcel

¹U.S. Postal Service: Pricing Postal Services in a Competitive Environment (GAO/GGD-92-49, Mar. 25, 1992).

post and overnight mail markets. Although the Postal Service developed both of these markets, private carriers dominate the profitable business-to-business segment and have left the Postal Service with the more dispersed and less profitable household market segment. While the Postal Service has lost market share in these smaller markets, its First- and third-class markets have grown, protected by what has been a monopoly position. However, since 1984, the rate of growth for third-class mail has declined to its lowest level since the mid-1970s. Rising postal rates have encouraged competition and diversion to other forms of communication, causing part of the decline.

Because of the substantial rate increases since 1988, some postal customers are actively seeking alternative means of communication. This competitive situation may create further decreases in Postal Service volume, reduce revenues lower than required to break even, and generate the need for more frequent rate increases to cover revenue shortfalls.² This in turn could further erode the Postal Service's market share and create a vicious cycle of volume and revenue shortfalls leading to still more frequent rate increases. Given this possibility, the question arises as to whether the criteria set forth in the Postal Reorganization Act of 1970 that guide postal ratemaking are still adequate in light of the competitive and changing environment the Postal Service faces.

The Postal Service recognizes from its lost market share in parcel post and overnight delivery that to be competitive it must control the growth in operating costs; offer its customers a full range of services that are prompt, reliable, and courteously delivered; and price its services to reflect changing demands for its products. Although it has begun to address the first two issues through its strategic plan, the Postal Service is constrained--by legislative design--in its ability to set rates.

Since the late 1970s, the Postal Service and the Postal Rate Commission have disagreed over the extent to which the ratemaking criteria allow the use of demand factors to be used in allocating the Postal Service's huge overhead burden among the various mail classes. This disagreement is the basic reason why the Postal Service's request in 1990 for a 30-cent First-Class stamp was reduced to 29 cents by the Commission and third-class rates were raised, on average, 8 percentage points higher than the Postal Service requested. The Commission also rejected volume discounts as a discriminatory pricing strategy when the Postal Service

²The Postal Service has reported net operating losses from 1987 through 1991 totaling about \$1.1 billion. About half of these losses were due in large part to legislative actions requiring the Postal Service to make unplanned payments for retirees' cost-of-living allowances and health benefit expenses.

proposed such a discount for its Express Mail service.

The ratemaking criteria set forth in the Postal Reorganization Act were established during a period when the Postal Service had less competition than it does now. Because the Postal Service is facing a changing and increasingly competitive environment that requires greater flexibility in pricing postal services, we believe that Congress should reexamine the nine criteria that the Postal Rate Commission considers in the ratemaking process to determine if the criteria are still valid in light of changing marketplace realities. We believe that demand pricing, which considers the "value-of-service" to the sender, should be given greater weight in the criteria used as a guide for allocating overhead costs and setting postal rates. Further, we believe that Congress should reexamine the question of whether volume discounts to large business users is in fact undue discrimination or preference given this practice's wide use by private carriers in competition with the Service. In the long run, if demand-based pricing is not given more weight in the criteria as one of several factors to be considered in ratemaking, the Postal Service could experience serious losses in its price sensitive third-class market as well as its second-class market and thus drive up the cost of First-Class postage to cover these losses. Congress could then be faced with demands to further open postal markets to competition or to subsidize the national delivery network through appropriations.

POSTAL AUTOMATION

Increased ratemaking flexibility will not, in itself, guarantee survival of the Postal Service in the competitive marketplace. Control of operational costs is also essential. Historically, mail volume growth every year has helped keep rate increases to about once every 3 years. Without such growth, revenue shortfalls combined with escalating operating expenses (up 6.9 percent in 1991) will generate the need for larger or more frequent rate increases. The major contributor to postal costs and their growth is employee pay and benefits. As a percentage of total operating expenses, employee pay and benefits have exceeded 80 percent for the past 20 years. Faced with the reality of not having complete control over employee pay and benefits, the Postal Service tries to make its workers more productive by making operational changes and capital investments in equipment and facilities. The latest and perhaps the most intensive effort to improve productivity is the automation program.

This program, with optical character and bar code readers as core equipment, became operational in 1982. It received renewed emphasis in 1988 when the Postmaster General announced a goal of bar coding nearly all mail by the end of 1995.

In response to congressional interest in automation, we have issued six reports on various aspects of this program since January 1983. The report being released today, prepared at the request of this Committee and its Postal Operations and Services Subcommittee, provides an assessment of the program's impact on productivity and labor costs during 1991.³

The Postal Service recognizes that automation provides one of the best and most effective ways to control costs if it is to stay competitive in the marketplace. However, although the Postal Service's automation program is producing savings in certain functional areas, it is unlikely to be a panacea that will reverse the persistent tendency for costs to outpace inflation.

Given that the Postal Service has spent \$2 billion on automated equipment and had a 9-digit bar code on 40 percent of the mail by the end of 1991, it is somewhat surprising that its measurement of savings remains ad hoc and inconsistent. Publicly, former Postmaster General Frank has cited the decline in the number of career employees as savings made possible by automation and related cost control initiatives in mail processing and delivery. This gross measure ignores the fact that workhours--the work actually put in by employees and paid for by the Service--have not fallen commensurately. When career employment was down 34,000 during 1991, overtime was higher by an amount equivalent to 15,000 full-time employees and work by non-career employees had increased the equivalent of another 3,000 full-time employees.

Notwithstanding the decrease in career employment and additional automation that was put in place in 1991, operating expenses for the year grew almost 7 percent and were \$295 million higher than expected. The total hours of work in the Service increased in 1991 although the volume of mail declined.

While hours worked did decrease in work functions most directly affected by automation, the reduction was only 1 percent from the previous year and little more than half of the planned amount. Because more than half of the work in the Postal Service is not directly affected by automation, this reduction in the affected areas did not have a perceptible effect on overall postal costs.

Workhour savings that have been achieved by automation are also being overwhelmed by annual increases in labor hour costs. For example, we estimate that workhour savings in 1991 in the functions most directly affected by automation amounted to about \$138 million. But the work in those functions cost \$627 million

³Postal Service: Automation Is Restraining But Not Reducing Costs (GAO/GGD-92-58, May 12, 1992).

more than the year before because of wage and benefit increases.

Finally, the Postal Inspection Service's ongoing audits of postal operations have identified inefficiencies in the use of people and equipment in automation and related operations. Reports from fiscal years 1990 and 1991 identified over \$187 million in lost savings as a result of ineffective procedures and administration.

Although automation is not likely to reduce costs nor become the predominant influence on postal costs, it has undoubtedly restrained their growth and thus has had a beneficial effect. Workhour reductions are continuing into 1992.

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Before closing I would like to turn briefly to future areas of oversight. Former Postmaster General Frank, in his farewell address, said that the success of the United States Postal Service in a competitive environment "may well come down to (these) two factors: how employees treat our customers, and how employees treat each other." We would agree that these considerations are fundamental and believe that Congress should, in its oversight capacity, carefully monitor the Service's progress under a new Postmaster General in addressing these two imperatives.

That concludes my prepared statement, Mr. Chairman. My colleagues and I would be pleased to respond to any questions.

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GAO PRODUCTS ISSUED SINCE 1991 OVERSIGHT HEARINGS

Postal Service: Automation Is Restraining But Not Reducing Costs
(GAO/GGD-92-58, May 12, 1992).

U.S. Postal Service: Priority Mail at Risk to Competition if
Double Postage Rule Is Suspended (GAO/GGD-92-68, May 7, 1992).

U.S. Postal Service: Pricing Postal Services in a Competitive
Environment (GAO/GGD-92-49, Mar. 25, 1992).

U.S. Postal Service: Work Hour Allocations to High Growth and
Low Growth Post Offices (GAO/GGD-92-54BR, Feb. 27, 1992).

Procurement Reform: New Concepts Being Cautiously Applied at the
Postal Service (GAO/GGD-91-103, Aug. 6, 1991).

Postage Stamp Production and Procurement (GAO/T-GGD-91-39, June
5, 1991).

U.S. Postal Service: Transfer of Mail Processing From
Parkersburg to Clarksburg, WV, Makes Sense (GAO/GGD-91-79, May
8, 1991).

Postal Service: Annual Distribution of 1990 Marketing Costs
(GAO/GGD-91-77BR, May 8, 1991).

Operational Performance of the United States Postal Service
(GAO/T-GGD-91-9, Mar. 5, 1991).

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